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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 1175

In the Matter
of
NEW YORK, ONTARIO AND WESTERN RAILWAY COMPANY,

Debtor,

THE PEOPLE OF THE STATE OF NEW YORK, THE DIRECTOR OF DIVISION OF SELF INSURANCE, THE INDUSTRIAL COMMISSIONER and the WORKMEN'S COMPENSATION BOARD OF THE STATE OF NEW YORK,

Petitioners,

against

RAYMOND L. GEBHARDT and FERDINAND J. SIEGHARDT, as Trustees of the above named Debtor,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Attorney General of the State of New York,
Attorney for Petitioners.

BATAVIA TIMES, LAW PRINTERS,
BATAVIA, N. Y.

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Respondents,

PETITION FOR WRIT OF CERTIORARI

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The People of the State of New York, the Director of Division of Self Insurance, the Industrial Commissioner, and the Workmen's Compensation Board of the State of New York, petitioners herein, respectfully pray for a writ of certiorari to review the judgment or "Order for Man-

date" of the United States Circuit Court of Appeals for the Second Circuit entered January 13, 1947 (R. 74), which modified an order of the United States District Court for the Southern District of New York (R. 7-8), entered pursuant to the opinions of the District Court, dated September 20, 1945 and April 4, 1946 (R. 9, 34-40).

Opinions Below

The opinions of the District Court (R. 34-40) are not reported. The opinion of the Circuit Court of Appeals (R. 68) is reported in 158 F. (2d) 769.

Jurisdiction

The Circuit Court of Appeals entered its order for mandate on January 13, 1947 (R. 74). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 [28 U. S. C. A. § 347(a)].

Summary Statement of Matters Involved

The case involves the question whether the District Court has jurisdiction to direct, in summary proceedings or otherwise, that officers, agents or employees of the State of New York turn over property to which the State claims title, as against the claim of the petitioners that the proceeding constitutes a suit against the State of New York in violation of the Eleventh Amendment to the United States Constitution.

Facts

1. On May 20, 1937, the Debtor filed its petition for reorganization under the then Section 77 of the Bankruptcy Act. Thereafter, the District Court appointed a trustee

who qualified and continued to act as such until December 22, 1944, when Raymond L. Gebhardt and Ferdinand J. Sieghardt were appointed as Trustees and qualified (R. 10).

2. Prior to the filing of such petition, the Debtor had delivered to the Industrial Commissioner of the State of New York securities belonging to the Debtor having a par value of $160,000, in compliance with and pursuant to Subdivision 3 of Section 50 of the Workmen's Compensation Law of the State of New York (R. 10), as proof of financial responsibility as a self-insurer (R. 53-54).

3. On December 21, 1943, the Trustee made application to the Industrial Commissioner of the State of New York for the return of the securities and prior to the institution of the proceeding in the District Court complied with certain conditions set forth by the Industrial Commissioner for the return of such securities (R. 11-14). The Trustee, however, failed to inform the Industrial Commissioner of an indebtedness of the Debtor to the State of New York for the Debtor's share of grade crossing eliminations constructed on the line of the Debtor's railroad pursuant to Chapter 678 of the Laws of 1928 (R. 13), in a sum in excess of $160,000 for past due installments (R. 15-16).

4. As soon as the State of New York ascertained that it had in the possession of a state agency the amount delivered to it by the Debtor at the time it became a self-insurer, the State asserted the right to apply it to the undisputed indebtedness to it for grade crossing elimination and instructed its officials not to turn over this amount to the Trustees and that it be applied in reduction of the indebtedness to the State of New York (R. 15-16).

5. Thereupon, the Trustees instituted a summary proceeding in the District Court for the Southern District of

New York to compel the State of New York and its various officials to turn over such securities (R. 42-49).

6. The State of New York and the various officials and boards sued as such filed an answer challenging the jurisdiction of the District Court to entertain the proceeding against them in view of the provisions of the Eleventh Amendment to the Constitution of the United States and by reason of the fact that the State of New York claimed the title to the property delivered to it by the Debtor and in its possession for the past due and unpaid installments of the Grade Crossing Elimination Tax amounting to $168,447.56 (R. 28-29, 55-57).

7. The District Court for the Southern District of New York held that the purposes for which the securities were delivered had been fully satisfied and discharged, and that, therefore, the Trustees were entitled to a direction for the summary return of such property (R. 34-40). The District Court, accordingly, directed the State of New York and the various state agencies named as such in the proceeding forthwith to surrender the securities to the Trustees (R. 8).

8. Upon appeal, the Circuit Court of Appeals for the Second Circuit modified the decision of the District Court so as to eliminate the State of New York as a party and to dismiss the petition as to it and otherwise affirmed the order of the District Court (R. 73).

9. In its decision, the Circuit Court of Appeals held that the State of New York had no proprietary interest in the securities; that even if it had a pecuniary interest, its claim was but colorable and that, therefore, the proceeding is not a suit against the State within the prohibition of the Eleventh Amendment to the Constitution of the United States (R. 71).

Specification of Error

The Circuit Court of Appeals has erred in holding that the proceeding is not a suit against the State of New York in violation of the Eleventh Amendment and that the District Court for the Southern District of New York had jurisdiction to entertain a summary proceeding which would require the State officers to turn over property which the State has in its possession and to which it claims title, by reason of the Trustees' indebtedness to the State for the monies due under the Grade Crossing Elimination Act.

Reasons for Allowance of the Writ

1. The question is one of general interest and importance. The extent to which the District Courts may limit the operation and effect of the Eleventh Amendment by an examination of the merit of a State's claim to property in the possession of its officials and a determination, after such examination, that the claim of the State is but colorable, are matters which call for earnest consideration and judicial clarification by this Court.

2. The suit is one against the State of New York, the petitioners having no personal interest therein and being sued solely in their official capacity as agents of the State. The decision of the Circuit Court of Appeals attempts to avoid the immunity of the State by omitting the State and by directing its order against the officers of the State, although they have no personal interest and are acting solely as agents of the State.

3. The adverse decision of the Circuit Court of Appeals is contrary to the recent decisions of this Court.

4. The construction by the Circuit Court of Appeals of Section 50, subdivision 3, of the Workmen's Compensation

Law of the State of New York, as creating a fiduciary relationship between the self-insurer and the State official to whom securities are delivered thereunder and barring any counterclaim to the property by the State was unwarranted, and was in effect the determination of a question of law that except for the pending proceeding in Bankruptcy could only have been determined by a suit in the Court of Claims of the State of New York.

WHEREFORE, Petitioners respectfully pray that a writ of certiorari issue to the United States Circuit Court of Appeals for the Second Circuit, commanding said Court to certify and send to this Court for its review and determination on a day certain to be named therein, a full and complete transcript of the record and all proceedings in the case numbered on its docket 20350, and that said decree of the United States Circuit Court of Appeals for the Second Circuit may be reversed by this Honorable Court, and that petitioners may have such other and further relief in the premises as to this Honorable Court may seem just.

Dated March 15, 1947.

THE PEOPLE OF THE STATE OF NEW YORK,
THE DIRECTOR OF DIVISION OF SELF INSURANCE,
THE INDUSTRIAL COMMISSIONER and the
WORKMEN'S COMPENSATION BOARD OF THE STATE
OF NEW YORK,
By NATHANIEL L. GOLDSTEIN,

Attorney General of the State of New York.

WENDELL P. BROWN,
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BRIEF IN SUPPORT OF THE FOREGOING PETITION

POINT I

The suit is one against the State of New York, the petitioners having no personal interest therein and being sued solely in their official capacity as agents of the State.

The Circuit Court of Appeals, in its opinion, recognized that *at least* so much of the order of the District Court as was directed specifically against the State of New York was in violation of the Eleventh Amendment, but held that by eliminating the State as a nominal party and modifying the order so as to deny the relief as against the State directly, the error of the District Court was cured.

However, the mere act of eliminating the State as a nominal party to the proceeding did not alter the fact that the proceeding actually is a suit against the State. The immunity of the State from suit in the District Court cannot be avoided by the expediency of limiting the suit to one against the State officials.

Louisiana v. *Jumel*, 107 U. S. 711;
Hagood v. *Southern*, 117 U. S. 52;
In re Ayers, 123 U. S. 443;
Breen v. *Mortage Commission*, 285 N. Y. 425, 429;
Saranac Land & Timber Co. v. *Roberts, Comptroller*, 195 N. Y. 303.

The State officials, here, are sued solely in their official capacity. They all constitute an integral part of the Department of Labor. Cf. *U. S. Dept. of Labor* v. *Remund as Admr, etc.*, U. S. Sup Ct., March 17, 1947 (U. S. Sup. Ct. Bulletin, Vol. 7, No. 19). They have no personal interest in the litigation. The property involved was delivered to them solely as State officials. Their possession is that of the

State of New York and they are subject to the direction of the executive officers of the State in dealing with such property. The State has directed its officials to apply this property to an undisputed indebtedness of the Debtor to the State in a sum in excess of the value of the property. The order of the Circuit Court of Appeals collides directly with the instructions given to these State officials by the State and, if complied with, would result in a pecuniary loss to the State of the value of the property which it has applied to the indebtedness of the Debtor. Under the circumstances, the proceeding is actually a suit against the State barred by the Eleventh Amendment to the Constitution.

Lankford v. *Platte Iron Works,* 235 U. S. 461;
Murray v. *Wilson Distilling Co.,* 213 U. S. 151;
In the Matter of State of New York, 256 U. S. 490;
Smith v. *Reeves,* 178 U. S. 436, 445;
Cargile v. *New York Trust Co.,* 67 F. (2d) 585 (C. C.A. 8th), cert. den. 292 U. S. 625;
Samuel Adler, Inc. v. *Noyes,* 285 N. Y. 34, 37;
Edlux Construction Corp. v. *State of New York,* 252 App. Div. 373, 375, aff'd, 277 N. Y. 635;
Metropolitan Trust Co. v. *State Board of Tax Commissioners,* 220 N. Y. 344.

POINT II

The decision of the Circuit Court of Appeals is contrary to the recent decisions of this Court.

In *Great Northern Life Insurance Co.* v. *Read,* 322 U. S. 47, a State official was sued for alleged illegal action. This Court pointed out that the State, as here, had provided a forum for the redress of illegal or invalid action. The Court said (at p. 51):

> "Efforts to force, through suits against officials, performance of promises by a State, collide directly with the necessity that a sovereign must be free from judicial compulsion in the carrying out of its policies within the limits of the Constitution. [Citing cases.] A State's freedom from litigation was established as a constitutional right through the Eleventh Amendment. The inherent nature of sovereignty prevents actions against a state by its own citizens without its consent."

In *Ford Motor Co.* v. *Department of Treasury,* 323 U. S. 459, the suit was against State officers, again on the ground of illegal action alleged to be in violation of the provisions of the United States Constitution. This Court held that the action was barred by the provisions of the Eleventh Amendment to the Constitution of the United States, saying (at pp. 463-4):

> "But, they [the State officials] were joined as the collective representatives of the state not as individuals against whom a personal judgment is sought. The petitioner did not assert any claim to a personal judgment against these individuals for the contested tax payments."

In *Kennecott Copper Corp.* v. *State Tax Commission,* 327 U. S. 573, the funds were in the possession of State officials as "escrow holder," and were segregated from the general funds of the State. This Court held that the State was an indispensable party.

It is submitted that the decision of the Circuit Court of Appeals is contrary to the principles upon which those cases were decided and violative of the Eleventh Amendment. There is no constitutional foundation for the examination of the substantive merit of the State's claim as a preliminary to a determination as to its immunity from suit either nominally or through its officials. Colorability

of a State's claim is not a factor in the disposition of the claim of immunity from suit barred by the Eleventh Amendment. If the substantive merit of a State's claim may be summarily disposed of, as was done in the instant case, then the constitutional immunity of the State from suit becomes but an illusion.

True, "the essential nature and effect of the proceeding" may be considered *(Mine Safety Co.* v. *Forrestal,* 326 U. S. 371, 374; *In the Matter of State of New York,* 256 U. S. 490, 500), but when it appears from the record that the officials are sued solely in their official capacity and that the State has asserted the right to apply the property in its possession to the undisputed indebtedness to it and claims title to it, it is mere abstract dialectics to assert that the State has no "pecuniary interest" in the property. The practical consequence of this conclusion is to deprive the State of this property to reimburse itself for advances made out of its funds for grade crossing elimination.

No authority was cited either in the opinion of the District Court or of the Circuit Court of Appeals which authorizes an examination of a State's adverse claim as a preliminary consideration to the determination of constitutional immunity of its officials from suits when, as here, suit is brought against them for acts performed by them in a governmental capacity solely as State officials.

The District Court relied for its decision on *In re Bajardi,* 9 F. (2d) 797 (C. C. A. 2d), cert. den. *sub nom. People et al.* v. *Wilson, et al.,* 270 U. S. 651, in which no question of jurisdiction was raised, and *In re Fidelity Assurance Ass'n,* 42 F. Supp. 973 (D. C. S. D. W. Va.), order reversed 129 F. (2d) 442 (C. C. A. 4th), cert. granted 317 U. S. 614, aff'd 318 U. S. 608, in which no pecuniary interest of the State was asserted.

The Circuit Court of Appeals did not cite or place reliance upon these decisions as furnishing authority for overruling the claim of immunity. But the authorities cited in its opinion are equally inapplicable. *Hobbs* v. *Occidental Life Ins. Co.*, 87 F. (2d) 380 (C. C. A. 10th), and *Porter* v. *Beha*, 12 F. (2d) 513 (C. C. A. 2d) readily may be dismissed, since in neither of those cases was there any claim of proprietary or pecuniary interest of the State asserted.

Hopkins v. *Clemson College*, 221 U. S. 636, also cited by the Circuit Court of Appeals, adds no weight to the conclusion that there is an absence of immunity of state officials when sued solely as such for acts in obedience to the State's command. The question involved in that case was whether a corporation, which, under the act creating it, could sue and be sued, was liable individually "for its own corporate act in building for its own proprietary and corporate purposes a dyke which it is alleged damaged or took the plaintiff's farm" (at p. 649 of 221 U. S.). But, at bar, the question whether an individual, state official or private citizen, is liable personally for a wrongful act is not involved. The suit is against state officials, not personally but strictly as such officials (they are not even named individually), for property in which the State on the record before this Court contends it has a pecuniary interest. It is to be noted that the statute providing for the offices and bureaus of the State officials in the instant case does not authorize suits against them.

POINT III

The construction by the Circuit Court of Appeals of Section 50, Subdivision 3, of the Workmen's Compensation, as creating a fiduciary relationship between the self-insurer and the state official, is unwarranted.

The Circuit Court of Appeals, in considering the substantive merit of the State's claim, was deciding a suit against the State. Insofar as the jurisdiction of the District Court was concerned, the mere fact that the State claimed title to the fund was sufficient to deprive the Court of jurisdiction, regardless of that Court's opinion of the merits of the State's claim.

The Circuit Court of Appeals, however, in construing Section 50, Subdivision 3, of the Workmen's Compensation Law of the State of New York as creating "a fiduciary obligation" with the state officers as pledgees "without power of disposition, except to return it." concluded that (at p. 771):

> "The state officers, themselves, obviously have no claim against the debtor under the Grade Crossing Elimination Act and cannot hold the deposit adversely to the trustees."

This construction of the state statute as creating a fiduciary relationship between the self-insurer and the state officials, is without support in the authorities and is contrary to the essential nature of the deposit. The officials of the State did not receive the deposit as individuals but as administrative agents of the State. Any trust is one for the breach of which suit might be instituted in the State Court of Claims. In the exercise of its governmental functions, the State has forbidden the employment of workers in certain occupations unless compensation for injuries is se-

cured and the securities in question were given over to the State in accordance with such legislative declaration. *Matter of McQueeney* v. *Sutphen & Myer,* 167 App. Div. 528.

There is no trust in favor of the depositing self-insurer. The employees are the beneficiaries of the deposit. Where any possible liability to them is otherwise protected as by the substitution of satisfactory insurance, the "trust" terminates and is at an end. It does violence to the language and intent of the statute to hold, as was done by the Circuit Court of Appeals that the trust continued for the benefit of the self-insurer. On the contrary, the property in the possession of the State, upon the termination of any interest of the employees in such property, was applicable to the indebtedness of the self-insurer to the State.

Implicit in the requirement for the deposit of the securities was the authorization to the State to subject the deposit to the payment of the indebtedness of the self-insurer to it, at least after all possible claims of employees have been met. *Siegel* v. *State,* 262 App. Div. 388.

The reasoning of the Circuit Court of Appeals that the claim of the State cannot be asserted by the state officials since they "themselves, obviously have no claim against the debtor" is unsound (p. 771). In *Hobbs* v. *Occidental Life Ins. Co.,* 87 F. (2d) 380 (C. C. A. 10th), relied upon by the Court, the Court pointed out (at p. 384):

> "Where property is held by a third person, that is one not a party to the action and he makes a claim of right or title in himself *or on behalf of some other person not a party,* and such claim is adverse to that of the receiver, a plenary suit is necessary to recover possession." (Italics ours.)

All the more applicable is the stated rule to a situation such as this, where the state officials hold as agents of the State.

The Circuit Court of Appeals in holding that the claim of the State is merely colorable even if it had a pecuniary interest relied upon *Libby* v. *Hopkins*, 104 U. S. 303, *Morris* v. *Windsor Trust Co.*, 213 N. Y. 27 and *Pink* v. *Title Guarantee & Trust Co.*, 274 N. Y. 167. None of these cases is in point.

Libby v. *Hopkins* may be dismissed from consideration because there the narrow question was whether the relevant section of the Bankruptcy Act authorized a set-off by an agent who had feloniously diverted funds sent to him for a special purpose. In the instant case the question is whether under the law of New York the State could have asserted the claim in response to any suit for the return of the securities. The Bankruptcy Act is not involved.

The New York statute (Section 266, Civil Practice Act, as amended in 1936), provides that

> "any cause of action in favor of the defendants or some of them against the plaintiffs or some of them, a person whom the plaintiff represents or a plaintiff and another person or persons alleged to be liable"

may furnish the basis of a counterclaim. Prior to the amendment of 1936, the right to interpose a counterclaim was substantially circumscribed.

The two New York cases cited by the Circuit Court of Appeals were decided under the former provisions of section 266, Civil Practice Act, and do not represent the correct rule of law under the amended statute. In *Morris* v. *Windsor Trust Co., supra,* the Court observed (at p. 29):

> "That the counterclaims do not come within the classes enumerated in section 501 of the Code of Civil Procedure does not seem to be doubtful. [Citation]. The question remains whether they may be sustained as set-offs either under section 68 of the Bankruptcy Act, or,

in view of the indorser's insolvency, under the general principles of equity."

Likewise, *Pink* v. *Title Guarantee & Trust Co., supra,* while decided by the Court of Appeals after the amendment to section 266, Civil Practice Act, was specifically limited to the construction of "former section 266 of the Civil Practice Act" (p. 172 of 274 N. Y.) and "within the meaning of section 266 of the Civil Practice Act, as it existed at the date of the pleading" (p. 177). How impossible, therefore, becomes reliance on these cases for the proposition that a set-off may not be asserted under the present statute to a "conversion" claim.

The State has a right to set-off against the value of the securities the amount of the indebtedness to it. Any other rule of law would deprive the State of a right accorded to other litigants.

Kaufman v. *Provident Savings Bank & Trust Co.,* 23 N. Y. S. (2d) 637, aff'd 263 App. Div. 703, leave to app. den. 263 App. Div. 809;
Bricken Constr. Corp. v. *Cushman,* 163 Misc. 371.

The Court of Claims of the State of New York has jurisdiction to "hear and determine a claim * * * for the appropriation of * * * personal property" or for the alleged tort of its officers and to "hear and determine *any claim in favor of the state against the claimant*" (Emphasis supplied). (Court of Claims Act, Sec. 9, added Laws 1939 ch. 860, in effect July 1, 1939.)

In accordance with the grant of such jurisdiction the State has waived immunity not only from suit but also from liability for the misfeasance or negligence of its officials or for damages for property, provided suit is brought in the Court of Claims (Court of Claims Act, Sec. 8; *Jackson* v. *State,* 261 N. Y. 134).

It is thus evident that the restriction imposed by the Circuit Court of Appeals on the nature of a counterclaim or set-off that may be asserted by the State is contrary not only to the practice applicable in the state courts, but also to the express language of the Court of Claims Act which authorizes the State to set-off any claim in its favor.

There is no plausible basis for the assertion that the counterclaim of the State, itself, is but colorable. There is, in fact, no dispute as to the verity of the claim. The alleged colorability is in the asserted inability to set-off this counterclaim against the property of the Debtor in the possession of the State. But the law of the State, as has been observed, affords the State the right to set-off any claim against the claim of the Debtor.

In any event, the question of the alleged inability of the State to set-off this indebtedness against the property in the possession of its officials under section 50 of the Workmen's Compensation Law, has not been decided by the Court of Appeals of the State or by this Court. In the process of restricting the State's immunity from suit under the Eleventh Amendment, the Circuit Court passed on the substantive merits of the State's claim and, thus, "passed on the initial interpretation and meaning of a state statute * * * without a previous authoritative interpretation of the statute by the highest court of the state." *Kennecott Copper Corp.* v. *State Tax Commission,* 327 U. S. 573. It is submitted that the Trustees should have been relegated to the Court of Claims of the State, a process by which such an "authoritative interpretation" would have been obtained, rather than the summary disposition by the Circuit Court of Appeals.

CONCLUSION

The writ of certiorari should be granted.

Dated, March 15, 1947.

Respectfully submitted,

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APPENDIX.

McKinney's Consolidated Laws, Vol. 64, Part 2, §50 17

IN THE

Supreme Court of the United States

October Term, 1946

No.

IN THE MATTER

of

NEW YORK, ONTARIO AND WESTERN RAILWAY COMPANY,

Debtor,

THE PEOPLE OF THE STATE OF NEW YORK, THE DIRECTOR OF DIVISION OF SELF INSURANCE, THE INDUSTRIAL COMMISSIONER and the WORKMEN'S COMPENSATION BOARD OF THE STATE OF NEW YORK,

Petitioners,

against

RAYMOND L. GEBHARDT and FERDINAND J. SIEGHARDT, as Trustees of the above named Debtor,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Statement.

Petitioners pray for a writ of certiorari to review a decree of the Circuit Court of Appeals for the Second Circuit entered January 13, 1947 (R. 72), which modified an order of the District Court of the United States

for the Southern District of New York, dated April 18, 1946, by eliminating the State of New York as a party and providing for dismissal of the petition as to it, and, as so modified, the order appealed from was affirmed (R. 72).

Respondents, as Trustees of the property of the Debtor, undergoing reorganization under Section 77 of the Bankruptcy Act, instituted a proceeding by petition in the Bankruptcy Court for a turn over order with relation to a security deposit of the Debtor, amounting to $160,000 par value of bonds, which prior to bankruptcy had been deposited by the Debtor as security for the performance of its obligations arising under the Workmen's Compensation Law of the State of New York (R. 42-49).

The order to show cause annexed to said petition and served with it was directed solely to the Director of Division of Self Insurance, The Industrial Commissioner and the Workmen's Compensation Board. The State of New York was not included as a party (R. 41).

The parties against whom the order to show cause was directed appeared by answer in which the People of the State of New York voluntarily joined. The answer is in the nature of a demurrer, denying none of the allegations of the petition, but raising a question as to the jurisdiction of the Court (R. 55-56).

The order of the District Court followed in which the securities, constituting the security deposit, were directed to be turned over to said Trustees (R. 31, 32, 33). An appeal was taken from that order to the Circuit Court of Appeals for the Second Circuit, which appeal was dismissed on the jurisdictional ground that it was not a final order.

The parties then entered into a stipulation as to the facts to which stipulation various exhibits were annexed

as a part thereof (R. 9-26). The stipulation was submitted to the Court upon the further petition of said Trustees praying for a summary order against the person, persons or Board possessed of the security deposit, which by then had been reduced to $80,055.03 by the voluntary surrender to the Trustees of $79,944.97 par value of securities (R. 25-27).

Said petition was followed by the order of the District Court, dated April 18, 1946, requiring the persons possessed of the security deposit, consisting of specifically described bonds, to surrender the same to said Trustees (R. 7, 8). From that order an appeal was taken to the Circuit Court of Appeals (R. 4, 5), which resulted in a modified affirmance. It is from this decision of the Circuit Court that the petitioners seek a writ of certiorari.

Facts.

The facts are fully set forth in said stipulation and in the exhibits annexed to and forming a part thereof.

The salient facts are that these securities are the property of the Debtor; and that long prior to the filing of the Debtor's petition for reorganization the Debtor deposited said securities with the Industrial Commissioner of the State of New York pursuant to subdivision 3 of Section 50 of the Workmen's Compensation Law to provide the security contemplated by law necessary to establish the Debtor as a self-insurer (R. 10).

The Trustee of the Debtor's property made due application for the release and surrender of the security deposit. On January 27, 1944, the Director of Division of Self Insurance, acting for the Commissioner of the Department of Labor of the State of New York, advised the Trustee by letter to the effect that the Industrial Commissioner had authorized and approved the release

of the security deposit on certain conditions, namely: that $79,944.97 be paid into the Aggregate Trust Fund; that certain obligations and administrative expenses be paid and that a self-insurance report be filed; and that there be provided a self-insurance release policy in the amount of $75,000 as security for the obligations arising out of the self-insurance periods specified (R. 11, 12).

All the conditions imposed were complied with (R. 13, 14). Thereafter the Director of the Division of Self Insurance, acting on the instructions of the Attorney-General, refused to turn over the deposit (R. 15).

Opinions Below.

The District Court by its unreported opinion, dated September 20, 1945, held that the securities were deposited with the Industrial Commissioner for the specific purpose of insuring the indemnification of the employees of the Debtor for any liability to its employees, arising under the provisions of the Workmen's Compensation Law; and that no right existed to dispose of the securities for any other purpose and that since all obligations intended to be secured were fully satisfied and discharged the Trustees presumptively are entitled to the return thereof (R. 33-40; fol. 117).

The subsequent opinion by the District Court, also unreported, is merely an announcement of its decision (R. 9).

The Circuit Court of Appeals rendered an opinion which is reported in 158 Fed. (2d) 769.

ARGUMENT.

POINT I.

The estate of the Debtor is summarily entitled to the return of its pledged property in which petitioners have no pecuniary interest; and the eleventh amendment is not applicable.

(a) The Industrial Commissioner received the deposit for the specific purpose of securing the liability of the Debtor to its employees for injuries arising under the Workmen's Compensation Law. Had the Debtor defaulted in that liability, of course, the deposit would have been applicable to make good the awards to the employees. However, there was no such default. Instead, the Director of Self Insurance designated the conditions upon which the deposit would be surrendered and returned. The District Court authorized the Trustees to comply with those conditions. One was the payment of $79,944.97 into the Aggregate Trust Fund to effect payment of the death claims. Another was the procurement by the Trustees of a self-insurance release policy for $75,000 to secure any contingent or future liability which might arise with relation to injuries not resulting fatally. Under the statute (§50, subdivision 3) that policy can never be cancelled.

When the Trustees had fulfilled all of the conditions imposed they were confronted with the manifestly unfair position that the Industrial Commissioner would refuse to discharge his fiduciary obligation and return the securities because of the direction by the Attorney-General, who undertook to divert the deposit to an obligation of the Debtor entirely foreign to the subject-matter of Workmen's Compensation.

Remington on Bankruptcy (5th Edition, Vol. 4), Section 1447 states:

> "§1447. Set-off by Pledgee of Excess Collateral against Unsecured Claims—The application of surplus collateral to a debt not secured by it is in the nature of a conversion. When the trustee sues to recover surplus collateral, the pledgee cannot set off counterclaims based on independent contracts."

Cardozo, J., writing for the New York Court of Appeals in *Morris v. Windsor Trust Co.* (213 N. Y. 27, 29), said:

> "I think the set-off is without sanction, either statutory or equitable. A wrongdoer who has misapplied the subject of a trust is not entitled, either under the Bankruptcy Act or under the rules of equitable set-off, to apply a credit that belongs to him in his own right in cancellation of his liability as a fiduciary. * * *
>
> "* * * This Court has many times held that a contract of pledge creates a fiduciary relation between the pledgor and pledgee. * * * After the debt secured by the pledge has been paid, the defendant held the pledge without beneficial interest or power of disposition. The one duty remaining was to preserve it safely and return it to the pledgor."

The Courts of the State of New York are not alone in requiring faithful compliance with fiduciary obligations.

In *Libby v. Hopkins* (104 U. S. 303) plaintiffs claimed the right to set-off an unsecured debt due from Hopkins against a sum of money remitted to plaintiffs by him with directions to apply it on his mortgage debt. This the plaintiffs refused to do and instead applied it on the unsecured debt. The Court in its opinion (p. 308) said:

> "Hopkins sent them the money and drafts, upon the faith and trust that they would be applied

> according to his instructions. The refusal so to apply them did not change the relations of the parties to this fund, nor make that a debt which before such refusal was a trust. To so hold would be to permit a trustee to better his condition by a refusal to execute a trust which he had assumed."

In *Alvord v. Ryan* (212 Fed. 83 C. C. A. 8th) it appeared that Alvord prior to his adjudication as a bankrupt delivered over to the defendant the title and possession of certain cattle to secure and indemnify the defendant for possible liability on an undertaking which he had executed upon request. The condition upon which the defendant might have become liable upon the undertaking did not arise. She sought to set-off the value of the cattle against an unsecured claim which she had against the bankrupt, but the Court (p. 87) held that this she was not permitted to do; that the defendant was the trustee of the plaintiff and that her holding of the money was not in the same right as was her holding of the claim against him; that the latter was personal whereas the former was fiduciary; that these were not mutual credits within the meaning of Section 68a of the Bankruptcy Act; and that the right of set-off did not exist.

In re Autler (23 Fed. Supp. 756) is another case of an attempted set-off of trust property to satisfy an individual claim against the bankrupt for breach of contract. Our Secretary of War, when a District Judge for the Southern District of New York, held that Section 68a only has application where the bankrupt and the creditor owe one another and does not apply where the bankrupt's property is in possession of a creditor as bailee or trustee.

The effort to set-off the security deposit against an obligation of the Debtor arising under the Grade Crossing Elimination Act of the State of New York is unwarranted under the rules of law or equity and is not

authorized or contemplated by the provisions of that statute (Chapter 678 of the Laws of 1928). Section 4, Subdivisions 2 and 3, of that statute provide for the repayment of funds advanced to the railroad; and in the event of failure or refusal of the railroad company to repay the installments as they fall due the same may be recovered as provided by Subdivision 3 of that section, which provides:

> "The comptroller may certify the amount or amounts so due and payable to the board of supervisors of the county or counties in which the crossing is located, whereupon, it shall be the duty of such board of supervisors to apportion the amount or amounts so certified to the several towns and cities in such county according to the assessed valuation of the real property of such railroad corporation or corporations or the successor or successors thereof in such respective towns and cities and to place the several amounts so apportioned on the respective assessment rolls of such towns and and cities and to issue its warrant or warrants for the collection thereof. Thereupon it shall become the duty of such towns and cities through their proper officers to collect the respective several amounts so apportioned in the same manner as other taxes are collected in such towns and cities and when collected to pay the same to the county treasurer of such county who shall thereupon pay the same into the state treasury. Any amount so levied shall thereupon become and be a first and paramount lien upon all real property of such railroad corporation or corporations or the successor or successors thereof within such respective towns and cities."

The validity and effect of the foregoing provision was before the Circuit Court of Appeals in a proceeding wherein it was sought to be determined that the mortgage liens upon the property of the Debtor had priority over any lien created pursuant to the provisions of the stat-

ute; and it was held that the mortgages were subordinate to the grade crossing lien.

> *State of New York v. Gebhardt, et al.*, 151 Fed. (2d) 802.

There exists nothing in the statute referred to to give any right to the State to the security deposit and nothing therein justifies a breach by the State or by its representatives of the provisions of the trust created by the third subdivision of Section 50 of the Workmen's Compensation Law.

(b) Petitioners have no pecuniary interest in the securities and the Eleventh Amendment, therefore, has no application. The claim to the contrary is without substance. Compliance with the summary order will have no bearing or effect upon the political or property rights of the State.

The Circuit Court of Appeals for the Second Circuit *In re Faour* (72 Fed. [2d] 719, aff'd 293 U. S. 613) considered a case where the debtors in bankruptcy had been private bankers. Pursuant to the New York Banking Law the state superintendent of banks had taken over all their assets for the purpose of liquidation. Thereafter petition was presented to the Federal Court for a composition under Section 74 of the Bankruptcy Act. The Federal receiver then made application for summary order to have the Superintendent of Banks turn over all property and to account for any paid out. Chase, J., among other things, said:

> "* * * Within its sphere the jurisdiction of a court of bankruptcy is paramount. * * *"
>
> "The District Court sitting in bankruptcy has ample power to administer all of the property and by summary order to require the appellant to turn it over to be administered."

This Court in *May v. Henderson* (268 U. S. 111, 69 L. Ed. 871), reversed the Court of Appeals for the Ninth Circuit and sustained the District Court in summarily directing the payment of money over to the trustee in bankruptcy. The late Mr. Justice Stone, writing for this Court, said at page 115:

> "• • • *But property held or acquired by others for account of the bankrupt is subject to a summary order of the court, which may direct an accounting and a payment over to the trustee or receiver appointed by the bankruptcy court.* (Cases cited.) • • • Courts of bankruptcy do not permit themselves to be ousted of jurisdiction by the mere assertion of an adverse claim. • • • It may disregard the assertion that the claim is adverse if, on the undisputed facts, it appears to be merely colorable. (Cases cited.)
>
> "• • • Having assumed to take possession of the property of the bankrupt for its account, it was their legal duty to turn the property or its proceeds over to the trustee in bankruptcy, or to account for their inability to do so by showing either a disposition of it in performance of a legal duty assumed toward the bankrupt or the bankrupt's trustee, or by clothing themselves with the protection of a claim adverse to the bankrupt, which was not merely colorable." (Italics supplied.)

See also:

Hopkins v. Clemson College, 221 U. S. 636, 31 S. Ct. 654, 55 L. Ed. 890, 35 L. R. A. (N. S.) 243.
Porter v. Beha, 12 Fed. (2d) 513, 517.
Cook County National Bank v. U. S., 107 U. S. 445.
Osborn v. United States Bank, 9 Wheat. 738.
Davis v. Gray, 16 Wall. 203.
In re Bajardi, 9 Fed. (2d) 797, cert. den. 270 U. S. 651.
Gamble v. Daniel, 39 Fed. (2d) 447, C. C. A. 8th Circuit; appeal dismissed 281 U. S. 705; cert. den. 282 U. S. 484.

Answering Petitioners' Brief.

The first two points of petitioners' brief propound legal doctrines with which this Court is not now concerned, since they have no application under the facts as stipulated. However, some observations and analysis of the cases cited by petitioners may be helpful to the Court.

Petitioners' Point I.

Notwithstanding the fact that the Court below dismissed the petition as against the State, the latter by joining in the petition for the writ is still insistent upon remaining in the proceeding as a party.

Petitioners say (p. 7) that the elimination of the State as a party does not alter the fact that the suit is still against the State, asserting that the immunity of the State from suit cannot be circumvented by limiting the suit to one against its officials. In support of this contention, petitioners have cited several cases, beginning with *Louisiana v. Jumel.*

None of these cases have any application. In each the property involved was that in which the State had a proprietary interest. The State, therefore, was the real party against whom the relief was sought.

Petitioners say (p. 8) that the State has directed its official to apply the property in question to an indebtedness owing by the Debtor and that the order of the Court below is in direct conflict with these instructions by reason of which it is said that the suit is actually against the State. Several cases are cited in support of the contention, beginning with the case of *Lankford v. Platte Iron Works.* None are controlling nor have they any application on the facts presented by this record. The

subject-matter of every one was something in which the State had a proprietary interest. None of them held or supported the position that the State has any legal right to direct its officials to become wrongdoers in violation of a lawful decree.

Petitioners' Point II.

The decision of the Circuit Court of Appeals does not conflict with any decision by this Court.

Great Northern Life Insurance Co. v. Read does not support petitioners' contention. This Court in its opinion (p. 51) said that a State could not be controlled by "courts in the performance of its political duties through suits against its officials."

Ford Motor Co. v. Department of Treasury of the State of Indiana was instituted by petitioner in the District Court of the United States for the Southern District of Indiana to compel a refund of gross income taxes paid to the Department. Of course, the suit was one against the State in which the latter had a direct pecuniary interest, the subject-matter being taxes already paid into the Treasury of the State as to which a refund was sought.

Kennecott Copper Corp. v. State Tax Commission involves the question as to the jurisdiction of the District Court with relation to a suit instituted to recover taxes illegally collected. Clearly the State was the real party in interest. Mr. Justice Reed, writing for the Court, said (p. 673):

> "This is a suit against the state. Utah has established an adequate procedure for the recovery of taxes illegally collected. When the state collects a tax under protest, the money is segregated and held for the determination of the taxpayers' rights with provision for any deficiency for interest or costs to be paid by the state."

Mine Safety Appliances Company v. Forrestal resulted in a dismissal of the complaint in which it is held that the United States was an indispensable party, Mr. Justice Black, who delivered the opinion of the court, saying (p. 167):

> "* * * The sole purpose of this proceeding is to prevent the Secretary from taking certain action which would stop payment by the government of money lawfully in the United States Treasury to satisfy the government's and not the Secretary's debt to the appellant."

In the Matter of State of New York this Court held that whether a suit is one against a State is determined "by the essential nature and effect of the proceeding, as it appears from the entire record" (p. 500). The proceeding involved the question of liability for damage occasioned while tugs were under charter to the Superintendent of Public Works and it was held that the proceeding essentially was one against the State.

It is well settled that a suit against an officer or agent of a State or of the United States is not necessarily a suit against the State or the United States; and that where the officer or agent makes claim to the contrary the burden is upon him to show that the State is the real party in interest; and that the Eleventh Amendment gives no immunity to officers or agents of a State withholding the property of a citizen without authority of law.

Tindal v. Wesley, 167 U. S. 204.
Sterling v. Constantin, 287 U. S. 378, 393; 77 L. Ed. 375.
U. S. v. Lee, 106 U. S. 196, 215, 216.

For decisions of State Courts holding to the same effect see:

Gladding v. Atchison, 44 R. I. 69; 115 A. 423.
State Mineral Lease Commission v. Lawrence, 171 Miss. 442; 157 So. 897, 898.

Thompson v. Auditor General, 261 Mich. 624; 247 N. W. 360, 362.
Dunne v. State, 162 Md. 274; 159 A. 751.
Alfred v. Esser, 91 Colo. 466; 15 P. 2d 714, 715.

Petitioners' Point III.

Petitioners say that the mere fact that the State claims title to the fund was sufficient to deprive the Court of jurisdiction, a position in conflict with the decision by this Court in *May v. Henderson, supra.*

Siegel v. State of New York is one where the receiver in bankruptcy surrendered a liquor license and became entitled to a refund. The State, however, applied the refund in payment of taxes due from the bankrupt. There, however, the refund merely constituted a debt to the bankrupt without any fiduciary relationship. Furthermore, the Liquor Law provided that on an application for payment of a refund all taxes and penalties due the State shall be deducted therefrom. No such provision is contained in the Workmen's Compensation Law.

Petitioners cite only a portion of Section 266 of the Civil Practice Act as amended in 1936, which has the effect of leaving the Court in the dark as to the purpose and scope of the section. It follows:

> "§266. Counterclaim defined.
>
> "A counterclaim may be any cause of action in favor of the defendants or some of them against the plaintiffs or some of them, a person whom a plaintiff represents or a plaintiff and another person or persons alleged to be liable."

A mere definition of a counterclaim is not calculated to change the substantive law. The section prior to amendment permitted a party to counterclaim a cause of action which arose out of the same transaction set forth

in the complaint or which was connected with the subject of the action, except that a cause of action on contract was the proper subject of counterclaim against any other cause on contract. The amended definition of a counterclaim includes any cause of action in defendant's favor against the plaintiff.

But there still must be a cause of action without which, of course, there can be no counterclaim; and it must be a cause of action of substance before it can be sued upon or counterclaimed.

The position of petitioners that the decisions in *Morris v. Windsor Trust Company* and *Pink v. Title Guarantee and Trust Co.* are now impaired by reason of the amended definition of a counterclaim is clearly unfounded.

The opinion of Cardozo, J., in the *Morris* case recognized that the counterclaims probably did not come within the enumerated classes of the statute, and the dismissal of the counterclaims resulted rather from the determination that the set-off was without any legal sanction and because the defendant was undertaking to repudiate its fiduciary obligation by reason of which it was referred to as a wrongdoer.

The reference in petitioners' brief (p. 15) to the *Pink* case is inaccurate and may well be misleading. A quotation is set forth from page 172 of the prevailing opinion and united with it without justification or reason is a quotation from the dissenting opinion; and the assertion is not well founded that the decision was limited to the construction of former Section 266. Instead, the Court was careful to point out that the claims of the parties were not held in the same right (p. 176).

Kaufman v. Providence Savings Bank & Trust Co. does not aid petitioners. There the plaintiff borrowed money of the defendant on a note and put up securities

as collateral thereto. The owner of the note then sold the collateral and plaintiff sued the noteholder for conversion. The Court held that a set-off was proper, since the debt owing by the maker of the note was admittedly overdue and unpaid at the time of the suit. Obviously no criticism can be directed against the conclusion of the Court. If the debtor here had defaulted on its workmen's compensation obligations, the Industrial Commissioner could have disposed of the security deposit to satisfy those obligations. That was the very purpose in making the deposit.

See:

Hughes v. Murphy, Inc., 169 Misc. 239.

CONCLUSION.

It is respectfully submitted that no question is presented which warrants a review by this Court, and it is urged that the petition be denied.

Dated, April 12, 1947.

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APPENDIX.

Vol. 64, Part 2 of McKinney's Consolidated Laws:

"§50. Security for payment of compensation.

"An employer shall secure compensation to his employees in one of the following ways:

"1. * * *

"2. * * *

"3. By furnishing satisfactory proof to the commissioner of his financial ability to pay such compensation for himself, in which case the commissioner shall require the *deposit* with the commissioner of such securities as the commissioner may deem necessary of the kind prescribed in subdivisions one, two, three, four and five, and paragraph a of subdivision seven of section two hundred and thirty-nine of the banking law, in an amount to be determined by the commissioner to *secure his liability to pay the compensation provided in this chapter.* The commissioner may also require an agreement on the part of an employer to pay any awards commuted under section twenty-seven of this chapter, into the special fund of the state fund, as a condition of his being allowed to remain uninsured pursuant to this section. The commissioner shall have the authority to deny the application of an employer to pay such compensation for himself or to revoke his consent furnished, under this section at any time, for good cause shown. The employer qualifying under this subdivision shall be known as a self-insurer.

"*If for any reason the status of an employer under this subdivision is terminated, the security bond deposit* referred to herein shall remain in the *custody* of the industrial commissioner for a period of at least twenty-six months. At the expiration of such time or such further time period as the commissioner may deem proper and warranted under the circumstances, and so designates, the commissioner may accept *in lieu thereof,* and for the

additional purpose of securing such further and future contingent liability as may arise from prior injuries to workers and be incurred by reason of any change in condition of such workers warranting the industrial board making subsequent awards for payment of additional compensation, *a policy of insurance furnished by the employer,* his heirs or assigns or others carrying on or liquidating such business. Such policy shall be in a form approved by the superintendent of insurance and issued by the state fund or any insurance company licensed to issue this class of insurance in this state. It shall only be issued for a single complete premium payment in advance by the employer. *It shall be given in an amount to be determined by the industrial commissioner and when issued shall be noncancellable for any cause* during the continuance of the liability secured and so covered." (Italics supplied.)